(Draft – Awaiting Formal Approval)

MINUTES OF THE
INFRASTRUCTURE AND GENERAL GOVERNMENT APPROPRIATIONS SUBCOMMITTEE

Room 445 State Capitol Building
July 30, 2015

Members Present:	Sen. Wayne A. Harper, Co-chair Rep. Gage Froerer, Co-chair Rep. Craig Hall, House Vice Chair Sen. David P. Hinkins Sen. Peter C. Knudson Rep. John Knotwell Rep. Justin J. Miller Rep. Douglas V. Sagers Rep. Scott D. Sandall Rep. Mike Schultz
Members Excused:	Sen. J. Stuart Adams Sen. Lyle W. Hillyard Sen. Karen Mayne Sen. Kevin T. Van Tassell Rep. Brad King
Members Absent:	Rep. Jacob L. Anderegg Rep. R. Curt Webb
Staff Present:	Ms. Angela Oh, Fiscal Analyst Mr. Brian Wikle, Fiscal Analyst Ms. Cami Deavila, Secretary

Note: A copy of related materials and an audio recording of the meeting can be found at www.le.utah.gov.

1. Call to Order

Co-chair Froerer called the meeting to order at 8:43 a.m.

2. Current Assets: Efficient Use of State Buildings, Current Replacement Value

Angela Oh, Fiscal Analyst, Office of the Legislative Fiscal Analyst (LFA), reviewed an issue brief recommending an increase in capital improvement funding from 1.1 percent to two percent of building replacement value and to fund capital improvements prospectively when buildings are approved and funded.

David Pulsipher, Performance Audit Director, Utah State Auditor's Office, reviewed findings of the 2014 performance audit of State buildings and land. Finding two showed the State could reduce leases by $4.6 million by consolidating 12 Salt Lake County leases into a State-owned building. Finding three showed six percent of State buildings were underinsured by almost $200 million. State agencies have the option to insure buildings for the actual replacement value or another value reported by the agency. Undervalued buildings increase State liabilities and affects capital improvement funding. The audit recommended State entities insure buildings based on replacement value, or receive a written exemption from the Risk Management. Finding four showed using vacant land could benefit State and local entities.

Rep. Sagers asked if the property in Utah County had a restricted deed and if proceeds from selling land could go back into building improvements. Mr. Pulsipher stated the deed was restricted and the Division of Services for People with Disabilities (DSPD) could use any proceeds from the sale of land as they desire. Rep. Sagers asked if a cost-benefit analysis had been completed on the practice of underinsuring buildings. Mr. Pulsipher stated they rely on Risk Management to set accurate rates.

Rep. Sandall asked if a cost analysis had been done on self-insuring all State buildings. Mr. Pulsipher stated the State self-insures through Risk Management.

Co-chair Harper asked if the audit looked into quasi-governmental agency buildings, if the lease consolidation would be a stand-alone building for each agency or all agencies combined into one building, and if the Governor's Office of Economic Development (GOED) was included in the multi-agency building. Mr. Pulsipher stated only State owned/operated buildings were included in the audit, lease consolidation would be into one multi-agency office building, and GOED was aware of the multi-agency office building recommendation. Co-chair Harper asked if the $4.6 million lease savings would cover debt service on the new building. Mr. Pulsipher stated the cost savings would be recognized after the break-even point in about 16 years.

Co-chair Froerer asked how State lease rates compared to market rates. Mr. Pulsipher stated rates were not included in the audit. Co-chair Froerer asked if lease payments were part of agency budgets. Mr. Pulsipher stated agencies that lease buildings make payments out of their budget. The cost of agencies that reside in State owned buildings was generally not recognized.

Ned Carnahan, Chair, Utah State Building Board, responded to the performance audit on State buildings and land.

Jeff Reddoor, Utah State Building Board, stated Risk Management had compiled an accurate inventory of State-owned buildings, including Higher Education, in the Riskonnect database that had been reconciled with DFCM. The inventory list was used to calculate the 1.1 percent value for capital improvement funding and insurance premiums. The Governor's Office of Management and Budget (GOMB) and LFA then review the numbers.

Kim Hood, Executive Director, Department of Administrative Services, stated agencies had the option to self-report building value or to use the Marshall and Swift comparison. The higher amount would be the replacement cost of the building. If agencies underinsure a building and an incident were to occur, the difference would be paid out of the agency budget. All building values were up to date.

Co-chair Froerer asked for clarification that any building loss due to being underinsured would come from the agency or from the State. Steve Hulet, Assistant Director, Risk Management, stated the yearly statement of values would report the higher amount of the value reported by the agency or the Marshall and Swift value. The agency could submit a written request to report the lower value but then be responsible for any loss due to being underinsured.

Sen. Hinkins asked if agencies could get competitive bids from the private sector. Mr. Hulet answered State agencies and Higher Education could not, but school districts could. All 41 school districts were insured with Risk Management.

Rep. Sagers asked if all of Risk Management's coverage was self-insured. Mr. Hulet stated there were 7,000 State buildings insured through Risk Management with $32 billion in coverage. Risk Management insures the first $1 million and bids out for any excess amount. There was currently $1 billion in excess coverage. Rep. Sagers asked if there was adequate insurance coverage. Mr. Hulet stated there was not adequate coverage but it would be prohibitive to insure for more. In the event of a disaster, they would rely on Federal Emergency Management Agency (FEMA) to make up the difference. Rep. Sagers was hesitant to rely on FEMA.

Co-chair Harper asked how the practice of underinsuring was allowed to begin and if there needs to be a change in policy or statute to require the higher of the two values. Mr. Hulet stated the decision came from the State Risk Manager.

Mr. Reddoor added the newly adjusted value of State buildings was also used to determine capital improvement funding, which would see an increase of about $20 million. Mr. Reddoor reviewed the process to annually review leases for possible tenant consolidation into State-owned buildings. It was recommended that a multi-agency building be constructed on the White Ball Field. The Building Board prioritized the project at number 16 on the priority list and the recommendation never came before the Legislature. DFCM was currently going through each county Recorder's Office and inputting data into AIM for a State-owned land inventory.

Rep. Sagers asked that the study for moving the State Fair Park be distributed to the Infrastructure and General Government Committee (IGG). Bruce Whittington, Interim Director, DFCM, stated the committee could receive a copy of the study.

Co-chair Froerer asked if the State had a good inventory of space utilization and cost.
Mr. Whittington stated there were no vacant spaces along the Wasatch Front.

3. Full Cost of Building Ownership: Operations and Maintenance (O&M) and Capital Improvement Funding

Kade Minchey, Legislative Auditor, reviewed Higher Education's management practices for O&M funding. Out of 11 recommendations, three had been fully implemented, one had been partially implemented, four were still in process, and three had not been implemented. Record keeping on O&M funding was not consistently maintained in 2014. The Board of Regents reported that a record tracking system was now being maintained. A policy on revenue generating had not been developed. The Board of Regents needed to consistently apply policy on renovated/replaced buildings. There was a difference in the O&M funding model between DFCM and Higher Education. DFCM costs increased while the Higher Education appropriation did not adjust for cost increases. Higher Education's management of auxiliary buildings was still inconsistent. Auxiliary classification affected capital improvement funding and was still in need of improvement. Risk Management and the Building Board data matching had improved but errors persist. Policy questions remained regarding use of reimbursed overhead funds. There was a recommendation that more overhead funds be used for O&M.

Co-chair Froerer asked if the Higher Education O&M line item goes through the Higher Education Appropriations Subcommittee or IGG. Mr. Minchey stated O&M for Higher Education goes through the Higher Education Appropriations Subcommittee. Ms. Oh reviewed the process for O&M requests.

Rep. Sagers stated Higher Education and IGG committees should be coordinating on O&M funding. Ms. Oh stated LFA would look into having committees work together on O&M funding requests.

Co-chair Froerer asked how Utah compared to other states with O&M funding and if a policy change was needed to have adequate funding. Mr. Minchey answered other states were jealous of Utah's O&M allocations. Tim Osterstock, Legislative Auditor, added that other states were hesitant to share O&M formulas.

Mr. Reddoor reviewed the process for calculating total cost for the life of the building. Buildings cost more to maintain than to build. The 10-year forecast for capital improvement needs was $1,195,000,000, including capital renewal and deferred maintenance costs. Funding was not keeping up with need. Audit recommendations included: the Building Board would keep a building inventory database; provide the inventory list to GOMB and LFA; create a policy that required a set interval review of all Higher Education buildings; audit the building inventory list for educational, auxiliary, and partial auxiliary buildings; and require all entities under jurisdiction to comply with the adopted auxiliary policy.

Ms. Hood stated O&M was funded when the building was built. DFCM manages around 200 building internal service funds where O&M can be adjusted as needed. Buildings not managed by DFCM can only adjust O&M when a building is remodeled or added on to. The Riskonnect system would allow an adjustment for a partial auxiliary building for accurate O&M reporting.

Co-chair Froerer stated DFCM was looking at changes for the way O&M was funded for older buildings versus newer buildings. Mr. Reddoor stated DFCM was in the process of forming a report with recommendations and models for O&M funding.

Rep. Miller asked if the 1.1 percent formula was not adequate to cover needs and what would be a more appropriate rate to fund Capital Improvement needs and wants. Mr. Reddoor stated DFCM was happy to see funding return to 1.1 percent. The industry and national funding standard was two percent. Rep. Miller asked if more would be paid down the road by not funding at two percent. Mr. Reddoor stated the cumulative amount would continue to increase if funding was left at 1.1 percent. Rep. Miller asked if funding was being used for aesthetic needs instead of the more critical needs of the building. Mr. Reddoor answered that critical needs were always addressed first.

Rep. Sagers asked if a present value analysis had been completed on deferred maintenance. Ms. Hood stated capital improvements were based on the value of the building and did not include inflation. Mr. Whittington stated national studies showed that by delaying deferred maintenance, projects would cost 6-8 percent more. Rep. Sagers asked if older buildings were not as effective and cost more to maintain and operate than to replace. Mr. Reddoor stated a study would need to be completed.

Co-chair Harper requested a total cost calculation be completed for every new building being considered by the Building Board and IGG. Mr. Reddoor stated some total cost information was included in the five-year plan but a total cost report could be added. Ms. Hood added the total cost would show current value, not projections.

Co-chair Froerer asked if the Building Board looked at the total cost of ownership when approving new buildings. Mr. Carnahan stated the Building Board was very aware of total cost of ownership.

Rep. Sandall asked for clarification that there were two models for O&M appropriations. Mr. Reddoor stated the DFCM model was based on actual current costs. Higher Education used a formula based on the CPI.

Ms. Oh explained the recommendation to increase current replacement value from 1.1 percent to two percent. Current capital improvement funding for FY16 is at $111.5 million. The appropriation amount would increase to $202.8 million if funded at two percent. Funding capital improvements prospectively would require an additional $5.5 million at 1.1 percent and an additional $10.1 million at two percent.

Rep. Miller asked if land value was included or just the replacement cost of the building when considering O&M and capital development projects. Ms. Oh stated just the replacement cost of the building.

Ms. Oh added the increase could be done in one year or incrementally over ten years. A total of $211 million would be needed to get to two percent funding.

4. State Building Board Process: Evaluate Proposed Changes and Outside Funding Intent Language

Ms. Oh reviewed intent language from item 45, Senate Bill 2, 2015 General Session.

Co-chair Froerer added clarification about the certification process for giving projects with outside money a higher priority ranking. Certification authority was given to the Building Board.

Mr. Carnahan reviewed the process for allocating O&M funding.

Rep. Sandall asked for clarification that there were two O&M funding models, one for State buildings and one for Higher Education buildings. Mr. Carnahan stated there were two processes and the Building Board was looking for a more effective process.

Sen. Hinkins asked if surplus O&M funds for a new building go into an account until it was needed. Mr. Whittington stated the Building Board had been directed to require State agencies and institutions to report O&M expenditures. Mr. Reddoor added that surplus funds for new buildings could be used on other older buildings needing repairs.

Rep. Miller asked if capital improvement funds go into a restricted account. Ms. Oh stated the appropriation goes into the agencies general operating budget. Mr. Whittington stated DFCM operates as an Internal Service Fund (ISF) and money for O&M is dedicated to a specific building. Surplus funds stay in a dedicated retained earnings account for future needs. Higher Education had a different model.

Rep. Sagers stated the committee should consider creating a restricted account for O&M funds.

Co-chair Froerer stated the Legislature would need to make recommendations to make the process more efficient.

Mr. Reddoor reviewed the policy for certification of other funded capital projects. The Building Board conducted ongoing facilities maintenance audits for State-owned facilities. Mr. Reddoor reviewed standards and requirements for capital development projects including the requirement for feasibility studies. The needs statement has been revamped. Mr. Reddoor reviewed the standards and requirements established for reporting O&M expenditures for State-owned facilities. The Building Board would prepare a report proposing a process for tracking O&M at an individual building level and alternative funding mechanisms for O&M. Ongoing facilities maintenance audits have been added to statutory language.

Rep. Miller asked if O&M funds were placed in an interest bearing account. Ms. Oh would look into it.

Rep. Sandall asked about the cost/benefit for tracking O&M at individual building levels. Mr. Reddoor stated the old system had no tracking at an individual building level. Co-chair Froerer added they would be looking at the offset to additional time involved versus outcome.

Brad Mortensen, Vice President of University Advancement, Weber State University (WSU), stated the amount WSU actually spent on O&M was greater than appropriations received.

5. Recess and Lunch Pickup

6. Working Lunch and Capital Improvements and Deferred Maintenance: Status of State and Non-state Funded Buildings

Mr. Reddoor presented a facility condition and current needs assessment. There were 1,656 deferred maintenance items totaling $33.6 million and 8,091 capital renewal items totaling $379.9 million.

Sen. Hinkins asked if leased buildings incurred maintenance costs. Mr. Reddoor answered typically maintenance was taken care of in the lease.

Co-chair Harper asked if rest stops, State parks, and rental residences were included in the building inventory. Mr. Reddoor stated they were included.

Rep. Sagers asked for clarification that O&M would increase five fold in 8-9 years and why there was such a dramatic increase. Mr. Reddoor stated the increase was due partly to aging buildings and underfunding of O&M.

Rep. Miller asked if the great number of deferred maintenance was because capital improvement needs were not being submitted to the Building Board. Would the $33.6 million cumulative costs continue to grow because capital improvements were not adequately funded year after year? Mr. Reddoor stated the highest needs were submitted with life safety issues being the highest priority and that keeping funding at 1.1 percent would not keep up with need.

Co-chair Froerer asked if the auditor staff needed an increase of one or two more FTE.
Mr. Reddoor stated the current auditors have had additional job tasks added to an already heavy workload.

Co-chair Harper asked if funding was adequate for the condition assessment audits. Mr. Whittington stated there was adequate funding to continue audits on a five-year rotation. Mr. Reddoor stated the value of buildings was currently being assessed.

Co-chair Froerer asked that water, electrical, and sewer infrastructure be assessed along with the buildings. Mr. Reddoor added that building value had been audited but building conditions had not been completed. When the value audit was completed, funds would be diverted for auditing the infrastructure conditions.

Rep. Sagers asked for clarification on why capital improvement cumulative funding was increasing so much. Mr. Reddoor explained funding that had been received versus funding they would need.

Mr. Carnahan stated support for having adequate support staff to gather information the committee and the Building Board need for decision making.

Mr. Whittington stated infrastructure funding would need additional funding. Condition assessment funding was coming out of the 1.1 percent improvement funding. The committee should look into using a different funding source for condition assessments.

7. Long-term Debt Models: Project Debt Levels and Debt Service

Co-chair Froerer stated the importance of understanding what cash pays for, what bonding pays for, and what debt levels would be.

Co-chair Harper stated State indebtedness needed to be reduced to the 50 percent range. The prison relocation funding would affect what the committee could do. Transportation projects were several billion dollars short.

Brian Wikle, Fiscal Analyst, Office of the Legislative Analyst Office, reviewed General Obligation debt. State indebtedness was at $2.5 billion. The estimated constitutional debt limit as of April 29 was at $4.2 billion. The debt per capita had been declining since 2012. About $350 million of debt service was coming out of the Transportation Investment Fund (TIF). Mr. Wikle reviewed transportation debt, prison debt, and water infrastructure debt models. The prison debt would be paid over seven years. Debt service would not increase if the debt were structured properly. Transportation debt had a 15-year pay off period. The earliest water projects would begin is 2020. Water debt would be paid off in 2055. The Legislature would need to decide if funds would be earmarked, come from the General Fund, or paid by water districts. Combining the water debt, transportation debt, and prison debt models showed a high spike in debt service in the early years. The model doesn’t consider bonding for additional buildings.

Rep. Sagers asked if the model assumed there would be no income from the sale of water to retire the debt. Mr. Wikle stated the model did not address the source of funding to pay debt. Water users would likely pay in to pay off the debt. Rep. Sagers asked if capitalizing interest on the water bond had been looked into. Mr. Wikle replied that pushing off payments increased the amount of interest needing to be paid.

Rep. Miller asked why interest rates came in at five percent instead of three percent and if bonds for the prison relocation had been looked at. Mr. Wikle stated the rate was a guess at future market conditions and the State Financial Advisor used a very conservative estimate. The numbers were hypothetical, but there was a downward trend in debt service.

David Damschen, State Treasurer's Office, stated the rates were very conservative estimates. Current market conditions were well under five percent.

Rep. Miller asked if prison bonds were being held pending additional action by the Legislature. Mr. Damschen stated they had authorization, but bonds were only issued on a once yearly basis.

Co-chair Harper stated the day's discussion was informational only and would be used to make decisions during the session.

8. Other Business

MOTION: Rep. Sagers moved to adjourn. The motion passed unanimously.

Co-chair Froerer adjourned the meeting at 1:20 p.m.